GSA

GSA Administrator

The Honorable Bud Shuster
Chairman, Committee on
Transportation and Infrastructure
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

The General Services Administration (GSA) hereby submits the plan for the Old Post Office (OPO) in Washington, DC, as required by Public Law 105-277. The plan must be approved by the Senate Committee on Appropriations, the House Committee on Transportation and Infrastructure, and the Senate Committee on Environment and Public Works before GSA can use Federal funds to (a) convert the building from office use to any other use, or (b) acquire the leasehold rights of the existing lease with private parties.

If you have any questions, please have a member of your staff contact Mr. Paul Chistolini, Deputy Commissioner, Public Buildings Service, at 202-501-1100.

Sincerely,

Thurman M. Davis, Sr.

Thurman M. Davis, Sr.
Acting Administrator

Enclosure

U.S. General Services Administration
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OLD POST OFFICE
1100 Pennsylvania Avenue, NW, Washington, DC

Congressional Request

Public Law 105-277, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, requires the General Services Administration (GSA) to submit a plan for the Old Post Office (OPO) before Federal funds are made available to (a) convert the building from office use to any other use, or (b) acquire the leasehold rights of the existing lease with private parties. The plan must be approved by the Senate Committee on Appropriations, the House Committee on Transportation and Infrastructure, and the Senate Committee on Environment and Public Works.

Background

The OPO, completed in 1899 as the Post Office Department headquarters and city post office, is one of the few major buildings of its period remaining in downtown Washington, DC, and is a central component of the Federal Triangle and the city skyline. Throughout most of the century, there were plans to demolish the building. In the early 1970s, local preservationists saved the building from destruction. Subsequently, Congress enacted the Public Buildings Cooperative Use Act of 1976 (CUA), legislation that allowed both Government and commercial enterprises to share federally owned buildings.

The original OPO development initiative grew out of the CUA. GSA's objective was to reinforce the economic life of the OPO and its Pennsylvania Avenue neighborhood. In 1982, GSA entered into a 55-year outlease with the Post Office Pavilion Joint Venture (POPJV). POPJV was the master lessee of the commercial retail space (109,000 s.f.) and, in turn, sublet space to retail shops and restaurant and food stand operators.

Current Situation

The OPO development under CUA has not worked for the following reasons:

- Poor tenant satisfaction and constant retail turnover;
- Economic underperformance;
- Change in development environment.

Poor tenant satisfaction and retail performance: The OPO has a very low level of Federal office tenant satisfaction as reflected in one of the lowest International Facilities Management Association scores in GSA's National Capital Region. The scores are low primarily for the following reasons:

- GSA has not made a major capital investment in the office space since the building was renovated in the late 1970s and early 1980s, due to many other competing claims on limited Federal Buildings Fund resources. Short-term reinvestment needed to sustain building operations is estimated to be between $4 to $6 million, including upgrading heating, ventilating, and air-conditioning system connections to the IRS Building. Major capital investment to bring the OPO closer to modern standards, including the replacement of some 100-year-old building systems and systems which were improved 20 years ago, is estimated at between $25 and $35 million.

- There have been conflicting objectives in the management of the retail and office portions of the building. For example, Federal tenants have different building circulation and security requirements than the private sector retail tenants and their customers. Also, public entertainment functions held during workweek business hours on the lower floors of the building are audible in Federal offices on the upper floors.

The OPO experienced constant retail turmoil and turnover; the original master lessee went into bankruptcy and the lender foreclosed on the master private leasehold. The original redevelopment never reached stabilized lease-up, and the East Atrium addition, built in 1992, failed to secure sufficient occupancy to keep the space open for business.

Economic underperformance: Under the current leasehold arrangement, the costs to GSA of supporting the building (both office and retail space) exceed the revenues. The retail concept, as originally conceived and subsequently revised and re-marketed, has never proven to be economically viable, either to the private leasehold interest or the Government.

Changed development environment: The retail market has changed since the 1970s, rendering the original development concept and leasehold structure obsolete. Attempts to change from the original festival retail concept (a concept which generally includes small boutiques and cart retailers) to destination retail (a retailing concept that incorporates the presence of major national retailers) have not proven marketable within the building structure because of inherent building limitations on signage, access from the outside, and insufficient space to reach a critical mass of retail.

The current situation with the building is unacceptable. GSA attempted to deal with many of these problems by negotiating to restructure the retail master lease on a sole source basis. Although the parties reached agreement in principle, the specific terms of the transaction were never agreed upon. GSA terminated negotiations in order to pursue a comprehensive redevelopment of the building.

Potential for Successful Development

There are two issues that need to be addressed regarding developing the OPO:

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(1) What to do with the current outleasing arrangement; and
(2) What is the best use of the facility.

Current Outlease: The Government loses money under the current leasehold agreement. Therefore, all of the potential options for developing the OPO, including status quo, call for the Government to buy-out the current retail leasehold interest.

Development Alternatives: Despite the flaws in the current housing arrangement, the OPO remains a valuable building that could be used for many purposes. Several alternative uses were evaluated, including development of the OPO as Federal office space and private sector development of the OPO for commercial office and hotel use. All alternatives assumed that the OPO would require major renovations. All of the alternatives involve a trade-off between two policy goals:

(1) Reducing the cost of Government to taxpayers; and
(2) Promoting economic revitalization in Washington, DC.

The analysis shows that the most economical alternative in terms of cost to the Government would use the OPO for Federal office use. The estimated 30-year present value cost of renovating the OPO for Federal office use is approximately $17 million less than the 30-year present value cost of outleasing the OPO as a hotel. On the other hand, outleasing the OPO for use as a hotel is likely to be the most effective vehicle for promoting economic revitalization in the District. A hotel would create activity on the south side of Pennsylvania Avenue and would help draw tourists to this area at all hours of the day and night. A hotel would ensure continued public access to this historic landmark and better support neighboring retail activities.

The analysis also considered alternatives that would outlease the OPO for commercial office use and/or residential occupancy. These alternatives were rejected because they would be more expensive than keeping the OPO for Federal office space without (in contrast to the hotel option) making a sufficient offsetting contribution to local economic revitalization. Moreover, compared to the recommended approach, these alternatives would require greater restrictions on public access to the OPO.

Recommendation

Under the recommended alternative, GSA will buyout the current retail leasehold interest and outlease the OPO to be used as a hotel under the National Historic Preservation Act, Section 111. GSA will proceed with this alternative, however, only if it receives an outlease proposal that protects the value of this historic asset, is financially sound, and has a cohesive redevelopment and operational concept. Such a proposal must clearly

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address the issues of building reinvestment, management, and use to ensure that the problems and conflicts that characterize the original outlease arrangement are not repeated.

In order to limit the cost to taxpayers, the recommended alternative will require that all proposals for the outlease meet or exceed a reservation price of $12.5 million. In addition, the alternative will require that the reservation price be paid up front. Together, these conditions would insulate taxpayers from the economic risk that inevitably attends any private commercial development, and ensure that financing for the hotel will be obtained from private capital markets and not, either explicitly or implicitly, from the Government. If no developer is willing to meet or exceed the reservation price in advance, then GSA will proceed with the next best alternative—renovating the OPO for use as Federal office space.

Authorization

Approval of this plan by the Senate Committee on Appropriations, the House Committee on Transportation and Infrastructure, and the Senate Committee on Environment and Public Works will constitute authority to acquire the existing leasehold and initiate a competitive master lease solely for the development as a hotel, with an up-front reservation price of $12.5 million.

Certification of Need

It has been determined that the above project is a Government need and that the proposed solution is the best way to proceed.

Submitted at Washington, DC, on December 28, 2000

Recommended: Robert A. Peck
Commissioner, Public Building Service

Approved: Thurman Davis Sr.
Acting Administrator, General Services Administration